

O 170656Z JUN 09  
FM AMEMBASSY BEIJING  
TO DEPT OF TREASURY WASHINGTON DC IMMEDIATE  
SECSTATE WASHDC IMMEDIATE 4584  
INFO CHINA POSTS COLLECTIVE PRIORITY  
NSC WASHDC PRIORITY

C O N F I D E N T I A L BEIJING 001635

STATE FOR EAP, EAP/CM, E  
TREASURY FOR OASIA/DOHNER/WINSHIP  
TREASURY FOR IMFP/SOBEL  
NSC FOR LOI

E.O. 12958: DECL: 06/17/2029  
TAGS: [ECON](#) [EFIN](#) [PREL](#) [OVIP](#) [CH](#)  
SUBJECT: TREASURY SECRETARY GEITHNER'S MEETINGS WITH  
CHINESE OFFICIALS, JUNE 1-2, 2009

REF: A. BEIJING 1571  
[1](#)B. BEIJING 1586  
[1](#)C. BEIJING 1618

Classified By: Economic Minister Counselor Robert Luke; Reasons 1.4 (b,d)

#### Summary

[1](#)1. (C) In the first of Secretary Geithner's June 1-2 meetings with Chinese officials, Minister of Commerce (MOFCOM) Chen Deming said China does not want its trade surplus with the United States to increase, as that would spur purchase of more U.S. Treasury bonds and generate additional U.S. criticism of China's low consumption and high savings rates. To reduce its trade surplus, China wants to import more U.S. high-tech equipment, but Chen claimed U.S. export controls constrain such trade. China recognizes the need to increase domestic demand rather than continue to rely on export-led growth, but altering domestic consumption will be gradual. China Securities Regulatory Commission (CSRC) Chairman Shang Fulin said CSRC is reviewing options to list foreign companies on the Shanghai and Shenzhen stock exchanges, as well as provide more choices to Chinese investors. CSRC is working with the Ministry of Finance to address the question of possible inspections of Chinese accounting firms by the U.S. Public Company Accounting Oversight Board (PCAOB). Shang noted that any unilateral sanctions by PCAOB against Chinese listed firms would be problematic for our bilateral relationship. Minister of Finance (MOF) Xie Xuren welcomed the Strategic and Economic Dialogue (S&ED) as a comprehensive partnership. In response to the global crisis, China adopted a "proactive" fiscal policy coupled with an easing of monetary policy, and China now appears to be emerging from the crisis. Xie is concerned about the potential for future U.S. inflation and the long-term sustainability of U.S. budget deficits.

[1](#)2. (C) Summary, continued. China Investment Corporation (CIC) Chairman Lou Jiwei raised three concerns: first, CIC is considering an increase in its Morgan Stanley stake but fears that could trigger a review by the Committee on Foreign Investment in the United States (CFIUS) and the Federal Reserve; second, CIC's inability to recover its investment and losses in the Primary Reserve Fund is unfair and embarrassing; third, Lou worries that the value of the U.S. dollar (USD) may be eroded by market concerns over rising U.S. Government debt. More broadly, Lou is concerned U.S. markets and investor confidence are rebounding before underlying problems in the financial markets have been fixed, so the current recovery may prove illusory. National Development and Reform Commission (NDRC) Chairman Zhang Ping said a rapid U.S. economic recovery is critical for both China and the world. China has responded to the global crisis with macroeconomic policy adjustments to boost domestic demand as the basis for more sustainable growth, and China will not support trade protectionism. China's economy has significant disparities, both urban-rural and regional, so the government has targeted its crisis responses on

infrastructure investments in central and western China and other long-term needs. Geithner stressed that reforms must lead to a reduction in external surpluses, as continuing large surpluses are not sustainable, and China cannot meet its goal of a balanced economy without further exchange rate reform. End Summary.

MOFCOM Minister Chen Deming

-----

¶3. (C) On June 1, Minister of Commerce Chen said the Joint Committee on Commerce and Trade (JCCT) and the S&ED are complementary, as the former focuses on specific trade issues while the latter has a more macro focus. Chen said he plans to attend the S&ED meeting in July in Washington. He does not want the trade surplus to increase, as that would spur China to buy more U.S. Treasury bonds and generate additional U.S. criticism of China's low consumption and high savings rates. But if the trade surplus continues to grow, China will nevertheless buy more Treasury bonds. Chen also said he understood the need for the U.S. fiscal deficit to expand, to pull the economy out of recession.

¶4. (C) Despite China's desire to expand trade and reduce its surplus with the United States, some Chinese entities hoping to purchase more U.S. high-tech equipment remain constrained by U.S. export control policies. Among the numerous Chinese companies wanting to buy such products, only a handful have been approved through the Verified End User (VEU) Program administered by the Department of Commerce, and all the approved companies are foreign-invested entities. One example of the problem is the small Z15 helicopter, co-developed by China and France to support search and rescue missions. Because a U.S. firm (Pratt & Whitney) supplied engines (built in Canada) for the aircraft, China feared any purchases would require export approvals from the U.S. Departments of State and Defense.

Rebalancing: A Gradual Process

-----

¶5. (C) According to Chen, China recognizes the need to increase domestic demand rather than continue to rely on export-led growth, but changing domestic consumption will be a gradual process. While western experts often focus on China's household savings, which are high due to the inadequate social safety net, in fact corporate savings are even larger. Changing domestic consumption patterns will take time, and in the meantime China likely will need to restructure its economy to reduce excess productive capacity.

In conjunction with measures to boost consumption, the Government plans to announce new policies to stimulate overseas investment. To further promote trade, the Government hopes to keep the RMB exchange rate stable.

U.S. and Global Recovery

-----

¶6. (C) Chen opined that not only did the U.S. need to clean up the toxic assets, but also to raise consumer confidence. Even though the Chinese economy is stable, it could not stand alone as the only successful economy without recovery in the U.S. and Europe. Perceiving a need for greater international cooperation, China is pressing for a larger role in the IMF and also increasing its aid to other countries. China remains aware that the current recovery could be a "fake recovery." Chen also queried Geithner on the risk of higher inflation in the U.S. and globally, noting that he has "some worries about that."

CSRC Chairman Shang Fulin

-----

¶7. (C) In a June 1 meeting, Geithner briefed Shang on the USG's plans for regulatory reform and restructuring of the U.S. financial sector, noting that China could "learn from our mistakes." Shang replied the U.S. has more successful experiences than lessons to offer, and remains the most successful economy in the world. In China, while markets are stable problems still exist, generally due to the lack of development, such as inadequate risk management, rather than high leverage. CSRC currently is reviewing options to list

foreign companies on the Shanghai and Shenzhen stock exchanges, as well as provide more choices of financial assets to Chinese investors. On the issue of possible inspection of Chinese accounting firms by the U.S. Public Company Accounting Oversight Board (PCAOB), Shang and Geithner agreed that each country faces legal limitations and urged each other to be creative, pragmatic, and flexible. Given that, the CSRC is working with the Ministry of Finance to seek possible solutions, and he urged PCAOB to avoid imposing unilateral sanctions. Shang and Geithner agreed to enhance bilateral exchanges to resolve the issue in a mutually acceptable manner.

Minister of Finance Xie Xuren  
-----

18. (C) During a June 1 meeting with Xie, Geithner observed that the U.S. and China share a common perspective on recovery. The world appreciates how the U.S. and China, individually and jointly, were handling the crisis. Our bilateral cooperation is a significant contributing factor to the modest positive indicators signaling slower economic deterioration. Xie characterized the S&ED as a comprehensive partnership. Asked if there were particular aspects of the former Strategic Economic Dialogue (SED) he would like to change for the new S&ED, Xie observed that now climate change, the environment, and energy will be handled in the Strategic rather than the Economic Track. He said the Economic Track of the S&ED should be outcomes-focused and suggested more frequent communications between the U.S. and China on the S&ED.

19. (C) Xie noted the Chinese Government is focused on stimulating domestic demand (especially consumption), by adopting a "proactive" fiscal policy coupled with an easing of monetary policy. Annual VAT, corporate and income tax reductions totaling RMB 550 billion would incentivize individuals to increase consumption spending. Xie understands the need for the U.S. stimulus, but expressed concern about the potential for inflation and the long-term sustainability of U.S. budget deficits.

CIC Chairman Lou Jiwei  
-----

10. (C) On June 2, China Investment Corporation (CIC) Chairman Lou Jiwei told Geithner that CIC (China's sovereign wealth fund) halted all new investments in 2008 due to risk concerns. Now, however, CIC is ready to restart foreign investment, but it will be both prudent and slow. For the U.S., Lou raised three concerns. First, in response to Morgan Stanley's (MS) efforts to raise additional capital to repay its Troubled Asset Relief Program (TARP) money, CIC is considering an increase in its MS stake (currently 7.6 percent), but is concerned that might cause its share to exceed the 9.9 percent threshold, which would trigger review by the Federal Reserve and the Committee on Foreign Investment in the United States (CFIUS). Lou asked if it would be possible for the Fed to expedite approval of CIC's request that this investment be exempted from restrictions on investment by bank holding companies, as the customary two-week process for considering such exemption requests is too long to allow CIC to take advantage of this opportunity. Second, regarding CIC's investment and losses in the Primary Reserve Fund, Lou said their inability to recover losses was unfair, as CIC had filed a redemption order before the fund folded. Although CIC's total loss in this matter -- tens of millions of USD -- was relatively small, the situation was embarrassing for CIC and the U.S. Securities Exchange Commission. Third, Lou is concerned about the future value of the USD, noting that the Federal Reserve's balance sheet has expanded from USD 800 billion to USD two trillion.

Future Concerns  
-----

11. (C) Lou queried whether major economies, such as China and the European Union, would be consulted when the U.S. Government including the Federal Reserve unwinds its extraordinary fiscal and financial support. Opining that former Secretary Paulson's TARP plan and the recent stress

tests both were good plans to address the financial crisis, Lou observed that U.S. financial institutions still must deal with their toxic assets to move forward. He is concerned that the recent stock market rally and recovery of investor confidence, which exceeded his expectations, have generated plentiful capital in the market, so the incentives for companies to endure the painful process of toxic asset disposal have been lessened. Furthermore, he worries that underlying problems in the financial markets have not been fixed, so the current amount of available capital and the stock market rally may be illusions that will be followed by another downturn.

NDRC Chairman Zhang Ping

-----

¶12. (C) In a June 2 meeting, Chairman Zhang said as the world's largest economy, the U.S. response to the global economic crisis has garnered significant attention in China, and a rapid U.S. recovery is critical for both China and the world. He stressed willingness to jointly tackle the crisis, but said efforts to boost domestic demand represent a long-term strategy; in the short term, exports will remain an important part of China's growth, although China would like to narrow the gap between exports and imports. He does not agree China's high savings rate and export volumes have caused global imbalances. China has responded to the global crisis with macroeconomic stimulus, while seeking to avoid future overheating. Through these policy adjustments, China hopes to transform old growth patterns into more sustainable growth, by boosting domestic demand, while also maintaining its openness to the outside world in the face of shrinking global demand. Zhang stressed that China will not support trade protectionism, citing recent Chinese buying missions to the European Union.

¶13. (C) Zhang said China's response to the global crisis reflects differences between its economy and that of the U.S. China's financial system is stable, but there are significant urban-rural and regional economic growth disparities. The government therefore has targeted its crisis response on infrastructure investments in central and western China, as well as investments in science and technology. Recent data indicate China's measures to address the crisis are having a positive impact and recovery has begun to take hold.

U.S. Economy

-----

¶14. (C) Geithner appreciated China's commitment to further openness and to oppose trade protectionism, and acknowledged that efforts to boost domestic demand would both take time and lay the foundation for a more balanced economy. He stressed that reforms must lead to a reduction in external surpluses, as continuing large surpluses are not sustainable for the rest of the world. The U.S. benefits from Chinese exports, but China cannot meet its goal of a balanced economy without further exchange rate reform.

¶15. (C) In response to Geithner's description of U.S. policy changes regarding energy, environment, and climate change, Zhang said China's recent fuel price increases have drawn public criticism on the Internet. He stressed the government's intention to ensure energy efficiency and also rely on domestic energy sources. He acknowledged the need to combat climate change, but only "rationally" through energy conservation and energy efficiency measures. The Chinese government has established an office for energy conservation, headed by Premier Wen Jiabao, and the eleventh five-year plan includes a target for reduction of energy use by twenty percent per unit of GDP by 2010. China also wants to phase out inefficient products and factories while introducing subsidies and price incentives for new energy-efficient products. Zhang noted that prices of many energy products are currently higher in China than in the U.S. China is very interested in incentives adopted in the United States for energy-efficient vehicles and hopes for cooperation on the UNFCCC.

Comment

¶16. (C) The comments by Geithner's interlocutors highlight that while the Chinese government seems satisfied with the effects of recent macroeconomic stimulus, it is unlikely to tighten policies until it is more confident about the sustainability of the U.S. recovery. There also remains concern whether the recent rebound in the U.S. financial sector is premature and may undermine efforts to address fundamental weaknesses in the U.S. financial sector. The sharp drop in external demand appears to have catalyzed a domestic policy consensus on the need to rebalance growth towards domestic demand and particularly consumption. However, both due to capacity and political constraints, Geithner's interlocutors attempted to contain expectations abroad on how quickly this rebalancing could be achieved. While many interlocutors expressed concerns about the risks of higher U.S. inflation, a weaker dollar, and their impact on the purchasing power of China's foreign reserve assets, none indicated that China intends to reallocate significantly the currency composition of its reserve holdings. Regarding exit strategies and the withdrawal of macroeconomic stimulus, they appeared to be particularly concerned about the ability and will of the Federal Reserve to unwind its liquidity facilities. This likely reflects the lack of legal and operational independence of the People's Bank of China, or any other central government institution.

PICCUA